

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 92-0017
Adjusted Gross Income Tax
For The Tax Period of 1986 through 1990**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax – Games of Chance

Authority: 26 U.S.C. §513, IC 6-3-2-3.1, IC 6-8.1-5-1, IC 4-32-3-2, *Treas Reg. §1.513-1, Ball vs. Indiana Department of Revenue*, 563 N.E.2d 522 (Ind. 1990), *Letter of Finding 95-0336*, *Gen. Couns. Mem.* 39,061 (Nov. 30, 1983), *IRS Announcement* 89-138, (Nov. 7, 1988).

The Taxpayer protests the assessment of gambling proceeds as unrelated business income.

II. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2.

The Taxpayer protests the imposition of penalty.

III. Tax Administration – Interest

Authority: IC 6-8.1-1-10-1

The Taxpayer protests the imposition of interest.

FACTS

Taxpayer is a partially exempt non-profit organization. Taxpayer was assessed gross income tax and adjusted gross income tax on unrelated income due to gambling proceeds. More facts provided as necessary.

DISCUSSION

Here, the Taxpayer was assessed gross income tax and adjusted gross income tax on “game boards” and other games of chance as unrelated business income. Taxpayer concedes the income is subject to gross income tax, however, maintains that the revenue should not be subject to adjusted gross and supplemental net income taxes.

IC 6-3-2-3.1 provides in relevant part:

- (a) Except as otherwise provided in subsection (b), income is not exempt from the adjusted gross income tax, or the supplemental net income tax, under section 3 (a) of this chapter if the income is derived by the exempt organization from an unrelated trade or business, as defined in Section 513 of the Internal Revenue Code.

Accordingly, the litmus test concerning the propriety of assessing Indiana adjusted gross income tax on the gaming income is whether the Internal Revenue Code would do likewise. The Internal Revenue Code (26 U.S.C. §513) defines unrelated business income as:

...any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501....

Also, *Treas. Reg.* §1.513-1 (d)(2) states:

Type of relationship required. Trade or business is “related” to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and is ‘substantially related,’ for purposes of section 513.

Taxpayer states that the organization is a non-profit fraternal order that provides benefits to its members as well as providing a program of charitable giving for the community. They state that the games of chance helped provide for those charities. Furthermore, Taxpayer argues that the federal rules regarding unrelated business income have distinguished between transactions conducted with an organization’s members or intended beneficiaries versus transactions conducted with the general public. They have provided *Gen. Couns. Mem.* 39,061 (Nov. 30, 1983) and *IRS Announcement* 89-138, (Nov. 7, 1988) to support their claim. Taxpayer has

provided affidavits from former administrators' of the organization stating that pull-tabs were not sold to non-members.

Prior to March 16, 1990, Indiana did not have a statute authorizing non-profit organizations covered under Section 501 of the Internal Revenue Code to offer games of chance. Consequently, these acts are considered illegal and cannot be considered to further the exempt purpose of the organization regardless if limited only to members. The General Council Memorandum and the IRS Announcement provided by the Taxpayer have no legal authority and would not apply to illegal activities.

Taxpayer also provides a prior *Letter of Finding* 95-0336 for another fraternal organization discussing the same issue. However, the *Letter of Finding* is only binding on the parties involved and cannot be used as precedent in this case. Furthermore, the protest period for the referred to *Letter of Finding* 95-0336 is 1991 through 1993 which is after Indiana adopted IC 4-32-3-2 allowing certain organizations to conduct contests, games of chance, raffles, and award door prizes.

Finally, Taxpayer argues that there was an extraordinarily long time between the Taxpayer's submission of a protest, and the scheduling of a hearing by the Department. Taxpayer contends that the doctrine of laches applies. The Indiana Supreme Court held in *Ball vs. Indiana Department of Revenue*, 563 N.E.2d 522 (Ind. 1990), that laches would apply if the Department acted "in an unusually dilatory manner." The Department previously sent several letters attempting to establish contact prior to the hearing and only received a response upon establishing a hearing date and time. Pursuant to IC 6-8.1-5-1 (b), Taxpayer carries the burden of proving that the Department is incorrect. Taxpayer presented no evidence that the Department acted in an unusually dilatory manner in this case.

FINDING

The Taxpayer's protest is respectfully denied.

II. Tax Administration – Penalty

DISCUSSION

IC 6-8.1-10-2.1(d) allows a penalty to be waived upon a showing that the failure to pay the deficiency was due to reasonable cause. Also, 45 IAC 15-11-2(c) requires that in order to establish reasonable cause, the taxpayers must show that they exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. The Department finds that the Taxpayer demonstrated reasonable cause for their failure to pay tax.

FINDING

The Taxpayer's protest of the penalty is sustained.

III. Tax Administration - Interest

DISCUSSION

Taxpayer protests the imposition of interest on the assessments. IC 6-8.1-1-10-1 does not allow the Department to waive interest. Therefore, Taxpayer's protest is respectfully denied.

FINDING

Taxpayer's protest is denied.